



# Memo

To: Elizabeth Hull, Deputy City Attorney,  
City of Chula Vista

From: Frederick H. Pickel

cc: Willie Gaters

Date: May 6, 2004

Re: Electricity Aggregation & Power Acquisition

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The purpose of this memo is to summarize my high level review of the Community Choice Aggregation ("CCA") and wholesale power acquisition components ("Generation Supply Strategy" and other power supply acquisition alternatives) of the "Municipal Energy Utility Feasibility Analysis Phase I Report" (October 10, 2003 and December 12, 2003 Drafts, or "MEU Draft").

In the context of this limited review related to CCA and the Generation Supply Strategy, I believe that the City of Chula Vista should follow no more than the least aggressive path, a "Low and Slow" approach.

1. This would be a low cost aggregation approach to an initially limited customer group, with out-sourcing of administration to qualified energy marketing organizations, similar to the approach that has been successfully used in Texas and New England. This is a lower initial cost approach than suggested in the CCA strategy in the MEU study. The City can use this approach to learn about the markets at a lower cost and risk than the suggested MEU Draft approach. The City need not take title to the power or the power generation assets.
2. The City should continue to participate in the development of California's CCA rules, stressing an approach to build on low-overhead successes in other states rather than inventing an elaborate and likely infeasible California program from scratch. The City should not move ahead with CCA until favorable CCA rules are established.
3. The MEU draft did not fully address the risks in developing an energy utility – Chula Vista should learn by doing in a limited risk way rather than making large initial commitments. The aggregation setup costs can be much lower than in the MEU draft.
4. Once the City is more familiar with the markets, if opportunities arise, the City can expand the scope of its activities.



### **Community Choice Aggregation for Electricity**

First, the rules for CCA are not fully established in California. The main uncertainty in developing such a program is the likely nature of any California legislation or CPUC regulation, current and future. Other states have successfully developed electricity purchasing aggregation programs, but the most successful programs are focused on specific market segments rather than full community programs.

Second, far lower initial implementation costs are possible than the \$4.2 million estimated by the MEU Draft. TCA and its affiliates have worked on the implementation of aggregation programs in Texas, Massachusetts, and Maine. These aggregation programs have been targeted as state-wide programs for non-profit or governmental entities only, rather than whole community programs.

In our experience with aggregation programs elsewhere, the startup costs are the external costs associated with professional services assisting in the strategy and negotiation of enabling agreements and standard form customer/ energy supplier contracts between the aggregation sponsor and one or more companies in the energy marketing business. In this “Co-op Purchasing” approach, the aggregation sponsor, like Chula Vista, coordinates the relationship with the marketers, provides form master agreements between the energy marketers and individual customers, and helps manage disputes. The cost for the aggregation sponsor involves 2 to 4 permanent staff plus initial outside professional help of \$300,000 to \$500,000.

With Co-op Purchasing, the aggregation sponsor does not take title to the power, and the marketer retains responsibility for the power acquisition to serve the customers. The City avoids the commodity risks associated with electricity in this approach, but also may miss out on larger potential savings associated with direct supply acquisition or generation ownership. In managing a Co-op Purchasing type aggregation, the City would gain familiarity with energy markets and with energy regulation.

At the other extreme, a CCA that has the sponsor take possession of the power commodity, its management, and the wholesale and retail billing processes can be very costly and is unlikely to be costs effective – the costs could be far in excess of \$4.2 million stated in the MEU draft. This “do-it-all-yourself” approach requires the development of internal risk management processes and billing systems with initial investment and



on-going operating costs that at least as high as those summarized in the MEU Draft, likely far higher.

The MEU Draft report does not explore aggregation alternatives in sufficient breadth. The California rules are not fully defined, so Chula Vista has the opportunity to shape the final format. There have been successful aggregation programs developed in other states – and it is possible to have a successful program without jumping into a full “do-it-all-yourself” CCA with high initial investment costs and high on-going annual operation costs along with a Generation Supply Strategy involving direct electricity procurement contracts and/or generation asset purchases.

	Co-op Purchasing ("Texas / Massachusetts Model" or out-sourcing approach)	MEU draft "Do-it-all- yourself" aggregation with direct supply contracts or generation acquisition
Setup cost	\$300,000 - \$500,000 once California rules are in place	At least \$4.2 million
On-going cost	2 to 4 staff plus <i>ad hoc</i> professional assistance on key issues	Much higher, not directly available in study
Net Benefits	Modest benefits at low City risk	Larger projected benefit, but substantial energy market risk to City

### **Electricity Acquisition and "Generation Supply Strategy"**

The Generation Supply Strategy approach in the MEU Draft is driven by the “do-it-yourself” CCA approach and potential Greenfield Developments. So, first, if Chula Vista decides to out-source aggregation development, it may be possible to avoid direct involvement in electricity acquisition – this avoids the risks but also reduces the potential benefits



related to municipal ownership. This out-sourcing approach may also be possible under a Greenfield strategy.

Second, the current electricity market is creating a difficult time for generation asset owners. Natural gas prices are up beyond prior expectations – and natural gas is the primary fuel for nearly all new generation. Electricity prices have not gone up enough, so that generation asset owners are in a pinch between slightly higher wholesale electricity prices and much higher gas prices. A number of key generation owners have financial troubles because of these factors. TCA analyses done over the past 2 years indicate that this situation will not be alleviated for 3 to 5 years or more, depending upon overall economic growth and western hydropower conditions. However, the price of new generation equipment for new generation projects and of troubled generation assets for new projects or those under development have not come down to a level where many purchases of assets are taking place.

This may create an opportunity for the City to obtain rights to electricity supplies through creative agreements with existing generation or projects that are in advanced development. For example, this might require customized agreements on development controls, property taxes, and their timing in return for a portion of the power supply. But this approach also requires the simultaneous development of a CCA, Greenfield, or Municipal Distribution operation that can use the power and efficiently dispose of any excess power.

The MEU Draft report does not explore power acquisition alternatives in sufficient breadth. First, it may be possible to out-source power acquisition under the CCA or Greenfield. Second, specialize agreements may be possible that might allow the City to obtain power at attractive prices – but this analysis would have to be specific to the opportunity, not a generic analysis like that presented in the report. Third, a MEU strategy based on the direct purchase of power via contract or by the acquisition of generation is very costly and risky.

### **Related Comments**

The report does not stress the volatility of energy markets. The City decision makers must be prepared for routine and sudden shifts in electricity and gas prices and related regulatory schemes – but this volatility does not mean that Chula Vista should not participate in these markets. In addition, energy prices not only move suddenly, they usually



move together. It is the gap between the prices of alternatives that provides the benefit to the City and its constituents (such as between Chula Vista supplied power and the prices offered by others). The City can directly or indirectly manage these risks, but must be prepared for the volatility and its active management.

The discussion would be improved by presentation of several scenarios that encompass both the energy market and political uncertainties related to the development of a municipal energy utility.

The MEU Draft appropriately proposes a phased Roll-Out Strategy. This MEU Draft should stress this phased approach, for example, starting small with a more limited implementation of a CCA or along with Greenfield Developments on a case-by-case basis, with supply acquisition out-sourced in a way where the City assumes little cost or risk.